BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF HAWAII

- - - - - - In the Matter of - - - - - - PUBLIC UTILITIES COMMISSION Instituting a Proceeding To Investigate Performance- Based Regulation.	DOCKET NO. 2018-0088

HAWAII PV COALITION
HAWAII SOLAR ENERGY ASSOCIATION AND
DISTRIBUTED ENERGY RESOURCES COUNCIL OF HAWAII
STATEMENT OF POSITION ON STAFF PROPOSAL FOR
UPDATED PERFORMANCE BASED REGULATION

AND

CERTIFICATE OF SERVICE

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Table of Contents

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The Hawaii PV Coalition ("HPVC"), Hawaii Solar Energy Association ("HSEA") and Distributed Energy Resources Council of Hawaii ("DERC") (together the "DER Intervenors") submit this Statement of Position pursuant to the Hawaii Public Utilities Commission ("Commission") Order No. 35542 and in response to the *Staff Proposal for Updated Performance-Based Regulations* dated February 7, 2019 ("Staff Proposal"). DER Intervenors have been active participants in the technical working groups and briefing throughout Phase 1 of the Commission's Proceeding to Investigate Performance-Based Regulation ("PBR") and appreciate the opportunity to provide these comments and recommendations in response to Staff's Proposal.

DER Intervenors applaud the process management skills of Staff throughout Phase 1 of this proceeding. The experience has been positive, professional, and productive. Moreover, the Staff Proposal provides a valuable synthesis of the parties' contributions through the Phase 1 workshops and briefs, as well as the tools available to the Commission as this proceeding

transitions to Phase 2. This work establishes a strong foundation upon which to develop the PBR framework and incentive mechanisms necessary to align the utility regulatory and business model paradigms to set the course to transform the electric utility industry in Hawaii in accordance with the directives established by the Legislature in Act 5.

I. Summary of Discussion

The Legislature's directives in Act 5 establish a bold transformational agenda for a cleaner, more affordable, and more reliable energy services sector in Hawaii that aligns the utility business model with customer interests and the market and technological realities that are rapidly transforming the electric industry. The Staff Proposal presents an organized set of prioritized goals and outcomes and a menu of regulatory mechanisms that could be implemented to achieve the Legislature's directives.

To this end, DER Intervenors agree with the Staff Proposal's assessment that "to support a continued transition toward a modern, customer-oriented business, the HECO Companies will need to foster innovation and design solutions outside of business-as-usual."[1] DER Intervenors emphasize that the ability of the HECO Companies to successfully make this transition turns in large part on their commitment to integrating distributed energy resources ("DERs") into utility grid planning and grid operations. The foundations of this proceeding must view DERs not only through the lens of "DER asset effectiveness" as an identified regulatory outcome to serve the goal of achieving "improved utility performance," but also as a class of resources that are required to achieve the prioritized goals and outcomes identified in the Staff Proposal.

DERs must be viewed in light of their unique operational capabilities, ownership attributes, and other characteristics—and by extension, non-utility market participants' expertise

[1] Staff Proposal at 13.

in developing and operating these resources. DERs are critical to provide the numerous grid services that will further the goals and outcomes identified in the Staff Proposal and in service of "a continued transition toward a modern, customer-oriented business."[2] To realize this opportunity and overcome the market entry hurdles and decades of bias against the use of DERs as utility resources for grid solutions, regulators and utilities must be committed to DER integration by embracing fundamental changes to grid planning and operation through collaboration with DER providers.

The PBR framework and regulatory mechanisms adopted in Phase 2[3] must enable a rapid transition to a customer-centric utility business model that integrates and leverages the capabilities of DERs, including the services of non-utility energy service providers, across the spectrum of prioritized goals and outcomes. The single most important overarching goal, and challenge, of the PBR process is implementing the appropriate balance of regulatory mechanisms to ensure that the resulting regulatory and business model paradigms "break the direct link between allowed revenues and investment levels."[4] To achieve this, utility incentives must be aligned with planning and procurement mechanisms that ensure DERs are evaluated on a non-discriminatory basis to provide cost-effective solutions to grid needs, enhance the customer experience, and achieve environmental and other societal goals over the near- and long-term.

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2 *Id.*

3 Order No. 35542 at 52 (stating ". . . Phase 2 of this proceeding will focus on designing and implementing specific modifications to the regulatory framework. This effort will be divided into three tracks: (1) PIMs; (2) Revenue Adjustment Mechanisms; and (3) Other Regulatory Reforms.").

4 Act 5.

DER Intervenors offer the following discussion in response to the Staff Proposal and recommendations for Phase 2 priorities to achieve the goals and outcomes identified in the Staff Proposal.

II. Summary of Recommendations

In order to complete the process of transitioning from the exploratory activities in Phase 1 into the implementation activities in Phase 2 of this proceeding, DER Intervenors recommend the following tasks for prioritization in Phase 2:

- *Monopoly and Competitive Market Functions* - examine, evaluate and make findings on the functions and services traditionally performed and provided by monopoly utilities that should be served by competitive markets; and those that can be served by monopoly utilities or competitive markets. This work will lay the foundation for transitioning to a customer-centric utility business model under the PBR framework to be adopted in Phase 2.
- *Platform Service Model* – formulate a strategic vision for Hawaii's electric utilities as platform providers and a strategic plan for transitioning the utilities' business model and practices to platform service providers. The strategic vision and plan should seek to align the platform model based on initial findings of those functions and services that should remain monopoly functions and those that should be provided by competitive markets. The utility platform should be tied directly to key, transparent results in PBR.
- *Performance Incentives and Utility Revenue Earning Opportunities* - develop a strategic plan for near- and long-term implementation of the PBR framework and utility earning incentive structures that: (1) incorporate upside/downside (incentive/penalty) structures for performance incentive mechanisms ("PIMs") and earnings sharing mechanisms

("ESM"); (2) utilize ESMs, PIMs, and capex/opex tools to tie statistically significant utility earning opportunities to defined metrics and performance targets as predecessor mechanisms to potential future revenue-cap and multi-year rate plan ("MRP") mechanisms; (3) establish differentiated returns on equity ("ROE") based on categorization of monopoly utility functions between lower and higher risk investments to more accurately link ROE with risk; (4) implement a platform service revenue model in the near term with clearly defined utility earning opportunities, and create a glide path for expanding platform earning opportunities and making adjustments to other PBR mechanisms over time; (5) set guidelines for determining when to translate reported metrics and scorecards into ESMs, PIMs, or other incentive mechanisms; and (6) set guidelines and procedures for developing and proposing innovative pilot programs for DER asset effectiveness, grid investment efficiency, transportation electrification, and resilience by utilities and competitive service providers.

- *Data* - immediately initiate a parallel proceeding or a process within Phase 2 focused on developing the data-rich environment necessary to stimulate and sustain DER integration and market innovation. This parallel proceeding should result in, among other things: (1) rules and procedures to enable customers and their designated agents to have "one-button" access to detailed consumption data; (2) rules and procedures to enable customers to securely share customer data and information with approved DER and other non-utility service providers; (3) guidelines for development of platform service revenue opportunities relating to system and aggregated customer data; and (4) a detailed plan for the gathering, reporting, and sharing of utility data necessary to support the development of PBR mechanisms in Phase 2, including data to support reporting metrics, scorecard

items, design components for PIMs, and ESMs, capex/opex equalization measures, revenue caps, and MRP.

- *Innovation* – building on the commercial-scale roll-out of the Grid Services Purchase Agreement ("GSPA") programs for DERs, incorporate incentive mechanisms in the PBR framework focused on pilot and demonstration projects to close additional gaps to effectively integrating DER solutions. This framework should include tariff-based procurement mechanisms, "Bring Your Own Device" programs, and other initiatives designed to rapidly scale the deployment of DER solutions to meet grid needs.

III. Comments on the Staff Proposal

DER Intervenors commend the Staff Proposal for its synthesis and thorough discussion of the many complex issues deliberated throughout Phase 1. DER Intervenors agree with and support the general direction and recommendations contained in Staff Proposal; however, DER Intervenors' position on some elements and recommendations differ with or put a different emphasis on those of the Staff Proposal. The following discussion provides DER Intervenors' position in response to the specific areas of discussion in the Staff Proposal.

A. Purpose and Aspiration of PBR

The Staff Proposal states that it "outlines common sense changes to utility regulations intended to help the HECO Companies operate more like a business in the competitive marketplace, with performance incentives that steer the utility toward achieving the state's goals at the least cost to customers."[5] DER Intervenors strongly support regulatory changes that guide the HECO Companies to operate in a manner that facilitates the integration of competitive markets as part of the portfolio of energy services available to customers in Hawaii. These

[5] Staff Proposal at 2.

changes should not, however, result in the HECO Companies, as a regulated monopoly utility, becoming competitive market participants themselves.

A core directive for the work ahead in Phase 2 must be to make critical findings about what monopoly functions and services the HECO Companies should continue to perform and provide under the PBR framework versus those functions and services that competitive market participants should perform. The Commission has previously emphasized the need to examine these issues in the context of pursuing "opportunities to 'unbundle' the provision of essential grid services to allow independent producers to offer these service through non-traditional technologies, such as demand response and energy storage systems, or non-utility owned generation, when more cost-effective."[6] Pursuing the opportunities identified by the Commission in its *Inclinations*, and additional opportunities identified in light of the continued electric sector evolution in this proceeding, will lay the foundation for determining the appropriate mechanisms to support the transition to a new utility business model and foster sustainable competitive energy service markets. DER Intervenors recommend as part of Phase 2 that the Commission include a process through which traditional assumptions about functions and services performed and provided by monopoly utilities can be examined and evaluated as a core element of utility sector transformation under PBR.

This examination should focus on the technological capabilities and financial and economic realities that inform which traditional monopoly functions and services should in fact remain as such and which are better served by competitive markets. The overall electric sector transition will take time; however this process should begin immediately. This transition should

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[6] Docket No. 2012-0036, Decision and Order No. 32052, Exhibit A at 8 ("*Inclinations*") (Apr. 28, 2014).

be based not only upon the HECO Companies actively seeking and implementing lower-cost competitive market solutions in place of traditional utility capital investments; but must also include the HECO Companies actively pursuing innovative means to integrate DERs and other competitive market resources to provide lower-cost solutions to grid service needs.[7]

This process may—and where appropriate should—result in fundamental changes to how customers procure and provide energy services from and through competitive markets as well as changes to the utility revenue model. The changes may include reduced earning opportunities in certain areas and new or increased earning opportunities in others. Integrating competitive market solutions into the utility business model will assist in establishing market frameworks that further drive a customer-centric business model and unleash the innovation and cost-saving opportunities competitive market forces can deliver. This fundamental change is the cornerstone to achieving the prioritized goals and outcomes identified in the Staff Proposal and the directives of the Legislature.

In sum, DER Intervenors support a focus on how the utility business model must evolve to incorporate competitive markets as a core purpose and aspiration for this proceeding. This proceeding should not; however, result in the HECO companies becoming competitive market participants themselves. The HECO Companies must in and of themselves continue to perform and provide such functions and services identified as being best served by a monopoly utility.

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[7] *See* Staff Proposal at 7 (stating "it is paramount that the Companies make efficient investments that are in the public interest and "[t]o that end, the HECO Companies should be properly incented to identify and implement non-capital solutions where such solutions can deliver greater value to customers").

B. Regulatory Goals and Outcomes

DER Intervenors support Staff's recommendation that the near-term focus in this proceeding be placed more on emergent outcomes than traditional outcomes.[8] The Staff Proposal identifies emergent outcomes as interconnection experience, customer engagement, DER asset effectiveness, grid investment efficiency, GHG reduction, electrification of transportation, and resilience.[9] A focus on these outcomes is critical to delivering immediate savings to customers and establishing the appropriate framework for achieving long-term success. As discussed further in the following sections, DER Intervenors recommend that Phase 2 prioritize the development the platform service provider model along with the appropriate suite of complementary regulatory mechanisms to support the animation of DER and other competitive service markets. The platform model will provide a critical foundation to integrating DER and other competitive markets into utility planning and operations and has a direct relationship to the HECO Companies' ability to achieve the emergent outcomes identified in the Staff Proposal.

C. Guiding Principles

DER Intervenors generally support the Staff Proposal's Guiding Principles but offer the following comments in response to provide additional context for DER Intervenors' positions.

1. *Customer-Centric Approach*

DER Intervenors strongly support the emphasis on a customer-centric approach to PBR as a guiding principle for this proceeding. However, it is helpful to explore and further define what a "customer-centric approach" means. The Staff Proposal discusses two elements to a customer-centric approach stating: (1) the "PBR framework should encourage the expanding

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8 *Id.* at 16.

9 *Id.* at 17.

opportunities for customer choice and participation in all appropriate aspects of utility system functions," and (2) "any PBR framework to emerge from this proceeding [should] include meaningful, verifiable, day-one savings for all customers."[10]

DER Intervenors support both of these elements to defining "customer-centric approach" but emphasize that this guiding principle must be more fully integrated into a PBR framework. Deliberate attention must be given to the role that PBR can and must play in facilitating the establishment of sustainable DER markets to expand choices for customers to manage their energy use and bills and to leverage customer-based energy solutions in response to grid needs. A key measure of whether the process is truly customer-centric is whether customer engagement through enrollment with, investment in, and adoption of DER-based services increases to meaningful levels.

Indeed, as the Commission's has previously emphasized, customer-sited DERs "can supply high-value grid services or offset future transmission-and-distribution infrastructure upgrades . . . at lower incremental cost than traditional grid upgrades."[11] To further underscore this point, the Commission's *Inclinations* states:

> The Commission views the objectives of lower, more stable electric bills and expanding customer energy options, while maintaining reliable energy service in a rapidly changing system operating environment, as essential principles that are the foundation for the future strategic business direction of the HECO Companies. By extension, these principles are also important criteria in the review and approval of future utility capital investment projects and programs.[12]

These principles of a "customer-centric approach," as defined by the Commission, should take a central role in guiding the development of a PBR framework that promotes DER market

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10 *Id.* at 21.

11 Docket No. 2014-0183, Order No. 33320 at 91 (Nov. 4, 2015).

12 *Inclinations* at 3.

animation to (1) expand customer choice in energy services, (2) empower customers to better manage their energy use and total costs, and (3) integrate customer-based solutions to meet grid service needs and provide lower-cost alternatives utility capital investments. DER Intervenors recommend that the Commission adopt a stronger commitment to a customer-centric approach than proposed in the Staff Proposal by incorporating the broader principle of DER market animation as a core element of defining the customer-centric approach. This will provide a critical organizing principle for developing the PBR framework necessary to achieve the electric sector transformation directed by the Legislature.

2. *Administrative Efficiency*

DER Intervenors agree with the Staff Proposal that "[t]he PBR framework adopted in this proceeding should serve to simplify rather than complicate the regulatory process and thereby reduce regulatory costs to the utility and its customers."[13] It is important to emphasize, however, that successful implementation of PBR, as defined by achieving the prioritized goals and outcomes identified in the Staff Proposal, is necessarily an iterative process that will require fundamental changes to the HECO Companies' investment strategies, grid planning and operations, and fundamentally, utility revenue earning opportunities over time. A short-term focus on administrative efficiency should not take precedent over conducting the hard-work that is necessary to ensure that the PBR Framework adopted in this proceeding lays the foundation for the highest likelihood of success over the long-term.

It is possible, and indeed likely, that at least in the near-term significant administrative oversight will be required to work through inherent complexities in the transition from cost-of-service regulation to PBR that may not immediately align with goals of simplifying the

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[13] Staff Proposal at 21.

regulatory process. This should not be viewed as a flaw, but instead should be considered a necessary investment in developing a successful PBR framework that also ensures administrative efficiency goals are realized and sustained over the mid- and long-term. As DER Intervenor HPVC stated in its Workshop 1 brief, articulating an overarching vision of what implementing PBR is intended to achieve will provide an important touchstone for evaluating the success of PBR implementation over time. This includes evaluating individual mechanisms for achieving prioritized goals and outcomes as well as how these mechanisms are coordinated to effectively facilitate fundamental utility sector transformation over time. DER Intervenors again offer the following vision statement for consideration:

> *A new regulatory compact and business model under which utilities and non-utility energy services providers can earn fair compensation based on performance in a clean energy economy that is aligned with the public interest to drive innovation, engage customers, and deliver reliability, resilience, and economic efficiency.*

3. *Utility Financial Integrity*

DER Intervenors agree with the Staff Proposal that "the utility is a critical community partner and serves an integral role in achieving the state's energy policy goals and serves as an essential credit-worthy off-taker for contracts for non-utility power purchases and new evolving grid services providers."[14] The Staff Proposal asserts that the "proposed Staff Framework will help to reduce regulatory lag and preserve the utility's opportunity to earn a fair return on its business and investments, while maintaining attractive utility features, such as access to low-cost capital."[15] As discussed further herein, DER Intervenors offer suggestions for building upon the proposed Staff Framework to better define what it means to preserve utility revenue earning

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14 *Id.*

15 *Id.*

opportunities in light of the fundamental changes that must occur to the utility business model in order to achieve the objectives of this proceeding and meet the directives of the Legislature.

D. PBR Framework and Regulatory Mechanisms

The regulatory mechanisms identified in the Staff Proposal offer a helpful survey of the suite of tools currently available to achieve prioritized goals and outcomes. To achieve these goals and outcomes, and in order to ensure that the emergent outcomes are prioritized in the initial stages of implementing PBR, these tools must be deployed in the right sequence and combination. As discussed herein, fostering sustainable competitive energy service markets, which include ensuring that DER integration is profitable for utilities and non-utility market participants, is a critical building block upon which achieving emergent outcomes and delivering cost-savings to all ratepayer depends. Certain mechanisms identified in the Staff Proposal, such as PIMs, capex/opex bias mitigation, innovation, and the platform service model, for example, can provide a high degree of certainty with low degree of risk with respect to the HECO Companies' ability to achieve targeted goals and outcomes. This is particularly the case for achieving emergent outcomes in the near term.

With these considerations in mind, DER Intervenors urge that Phase 2 of this proceeding include embarking upon the critical work of creating the conditions necessary for sustainable competitive energy service markets, including DER markets, to flourish in Hawaii. This work should include identification of functions and services that should remain monopoly utility functions, which should be served by competitive markets, and where monopoly utilities and competitive market providers may both be suited to provide certain traditional utility functions and services. The platform service model is particularly well suited to facilitate this process and transition through a transparent market-based framework for integrating competitive energy

service providers and DER assets into grid planning and operations while at the same time providing meaningful earning opportunities for utilities as a market neutral platform services provider.

DER Intervenors provide further discussion of specific elements of Staff's proposed PBR Framework, tracking the Framework Summary set out in Table 3 of the Staff Proposal, and certain regulatory mechanisms discussed therein.

1. *Revenue Adjustment Mechanisms*

a. MRP and Indexed Revenue Cap

The Staff Proposal provides a thoughtful discussion of revenue adjustment mechanisms that could be part of the PBR framework, with significant emphasis on MRP and an indexed revenue cap. DER Intervenors do not oppose MRP as a regulatory mechanism for implementing PBR per se. However, certain data, risk analysis, and other information necessary to develop a revenue cap index, productivity factor, and other elements of the MRP and revenue cap are not currently known or must be better understood before implementing these mechanisms as a main component of PBR at this stage. These challenges can be overcome with time; however, additional foundational work must first be completed to inform threshold decisions on MRP and revenue cap design, and more data and analysis must be gathered and conducted before implementing these mechanisms as a core element of the PBR framework.

This work includes identification of the costs and earning opportunities that MRP and revenue cap index should include and facilitate and how other PBR mechanisms would interact with a revenue cap and MRP to ensure that appropriate guardrails are implemented to mitigate risk and avoid unintended consequences. These are fundamental issues that should first be informed by findings about which functions and services the monopoly utility should perform

and provide. These findings should also inform, among other things, whether and to what extent certain functions should be subject to differentiated returns on equity based on updated understandings of relative risk and other criteria.

The Staff Proposal recommends that "the initial base revenues and rates for each utility MRP be set at the target revenues and rates in place (or pending determination in an open rate case) at the time the updated PBR framework becomes effective."[16] While this would further the goal of "administrative efficiency" by foregoing setting an updated baseline of target revenues and rates, utilizing existing revenue requirements and rates could further hinder the potential effectiveness of these mechanisms for the initial five-year term by maintaining status quo assumptions about utility investment plans and revenue requirements. Moreover, this could further delay the opportunity to restructure return on equity regimes to better reflect risk, including capex and opex equalization mechanisms, and other variations of return on equity, including differentiated rates of return based on findings regarding utility and competitive market functions and services and associated risk of certain utility capital investments in light of these findings.

Utilizing existing revenue requirements and target rates also comes with inherent biases about how those revenue requirements were determined and how the rates are structured to recover the revenue requirement. This approach could reduce the ability of other mechanisms, such as PIMs, capex/opex equalization mechanisms, innovation programs and incentives, and platform service revenues to be integrated into a PBR framework that is primarily driven by an MRP and revenue cap based on outdated baseline assumptions. The integration of these other mechanisms into the PBR framework is critical to ensure the utility is appropriately incentivized

16 *Id.* at 27.

to reduce overall costs *and* achieve other prioritized outcomes as part of its cost-reduction strategy.

As the Staff Proposal recommends, the near-term focus of PBR should be on achieving emergent outcomes. A fundamental driver of achieving emergent outcomes will depend on the PBR framework facilitating the emergence of sustainable competitive markets, particularly DER markets. It is likely that near-term implementation (*e.g.*, in the 1 to 5 year timeframe) will require more regulatory oversight than less to guide the transition process, and must include processes for defining the services and functions that should either be served by monopoly utilities or by competitive markets, and for unbundling appropriate services from the monopoly utility business model.

A five-year MRP also cedes some of this oversight ability and creates uncertainty with respect to when and what extent utilities implement certain programs at the expense others, and how aggressively utilities attempt to retain certain functions and services at the expense of competitive market integration. This is a particular concern with regard to the MRP and revenue cap frameworks as they can create an earning incentive environment in which a utility can pursue certain objectives at the expense of others while still being able to demonstrate savings over the course of the five-year plan. This can undermine the ability of these mechanisms to incentivize robust utility support for integrating competitive market solutions, particularly DER market solutions, and other policy priorities that can deliver significant ratepayer benefits, especially in the near-term.

b. Revenue Decoupling

The Staff Proposal recommends continued utilization of revenue decoupling through the existing revenue balancing account ("RBA"), which "would continue to serve as the mechanism

for implementing adjustments to accrued revenues and reconciliation of collected utility revenues, including adjustments resulting from the ARM, PIMs, and other interim adjustments specifically ordered by the [C]ommission."[17]

A fundamental goal of this proceeding is to establish a PBR framework through which utilities are incentivized to find more cost-effective means for delivering reliable energy service to customers and provide "day-one" savings to all customers. Revenue decoupling is a reasonable mechanism for mitigating some flaws in the traditional cost of service model by mitigating some utility bias or *disincentive* against energy efficiency, DER adoption, or other customer-based actions that reduce utility kWh sales and/or slow load growth. However, it does not provide an *incentive* for utilities to, for instance, invest in energy efficiency or facilitate greater DER adoption. It also stands as a significant obstacle to the "day-one" savings and is contrary to market-based and performance-based determinants of utility profitability.

A fundamental tenet behind revenue decoupling is that the target revenue to which the decoupling mechanism applies is achieved for the target period. While this serves to ensure that the utility's revenue requirement is met regardless of sales volume, the baseline revenue requirement to which revenue decoupling is tied is a creature of cost-of-service regulation. That is, revenue decoupling may be an appropriate revenue adjustment mechanism to include in a near-term PBR framework that relies on certain traditional cost of service based revenue requirement and revenue earning opportunity assumptions. However, the mechanism should be replaced with PIMs, capex/opex equalization mechanisms, innovation incentives, and other mechanisms once revenue requirement and revenue earning opportunity assumptions are determined according to PBR framework assumptions.

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17 *Id.* at 28.

c. Earning Sharing Mechanisms

The Staff Proposal recommends "implementation of a revised ESM that provides both 'upside' and 'downside' sharing of earnings that fall outside of a Commission-approved range" based on careful consideration of "the overall framework of regulatory provisions, including the full portfolio of existing, modified, and new PBR mechanisms in effect."[18] DER Intervenors support the Staff Proposal's recommendation but believe that ESMs should be viewed as a transition mechanism toward revenue models based purely on performance and should be carefully shaped to specific sets of identified functions. ESMs appropriate a share of earnings above the target for the benefit of customers, but like a tax on excess profits, can stifle bold action and invite gaming. For symmetrical ESMs, at the other end where customers must contribute to making up unearned revenues, the same problems exist. While ESMs mitigate the uncertainty associated with early-stage PBR implementation, they are not a desirable end-point for market development. To manage against uncertainty and gaming risks, ESMs, where used, should be narrowly structured to measure earnings associated with specific, trackable, and well-understood functions.

DER Intervenors also highlight Staff's cautionary note above to emphasize that ESM must be developed to ensure against gaming the PBR framework such that, for instance, mediocre utility performance in areas where utility earnings are tied to PIMs are not translated into "savings" that would trigger ESM based revenues. DER Intervenors recommend the Commission incorporate either through a parallel proceeding or as part of Phase 2 a detailed plan for the gathering, reporting, and sharing of utility data necessary develop ESMs.

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[18] Staff Proposal at 29.

2. *Performance Incentive Mechanisms*

a. PIMs

The Staff Proposal recommends that the Commission "consider establishing between three and six PIMs that, in total, would provide the HECO Companies with incentives that would increase or decrease earnings by 150-200 basis points."[19] The Staff Proposal states "this magnitude of potential utility revenues tied to achievement of priority outcomes reflects a sufficient fraction of the utility's income in order to motivate meaningful improvements in performance."[20]

DER Intervenors believe it is premature at this stage to cap the total basis point potential for PIMs to increase or decrease utility earnings. The total basis points assigned to any individual PIM should be determined based on the level of importance assigned to the utility achieving that particular metric. In other words, if a PIM scheme allocates basis points for four separate metrics, the total basis points allocated to each metric should be based on whether the total basis points assigned to any particular PIM are sufficient to incentivize meaningful utility performance in the furtherance of that metric. While it is helpful to consider the relative importance one metric as compared to another in an overall PIM scheme, the total number of basis points assigned to any particular PIM should remain a function of the relative importance of the goal to which that individual metric is mapped to achieving.

With respect to PIMs as part of the PBR framework, DER Intervenors emphasize that, as with ESMs, PIMs will be much more effective if applied only to the costs and earnings associated with specific functions performed by the utility. Further, PIMs set to provide basis

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19 *Id.*

20 *Id.* at 34.

point earning enhancements (or penalties) on an enterprise-wide basis but targeted to specific functions may both overshoot and under-incentivize the achievement of targeted outcomes. For example, in order to create an incentive for expedited interconnection of DERs, an associated PIM should provide incentive earnings levels for all spending specifically associated with DER interconnection, but not also for unrelated spending elsewhere in the utility enterprise. This would allow for higher and more targeted PIMs. DER Intervenors anticipate continued discussion of these concepts in Phase 2.

b. Scorecards and Reported Metrics

DER Intervenors agree with Staff that reporting and tracking mechanisms have a valuable role to play in supporting the PBR framework, including non-PIM mechanisms. As stated in its Workshop 3 brief, DER Intervenors recommend that the Commission translate the information gathered through scorecards and reported metrics into dashboard tools that can be used to educate and inform the public and competitive service providers about system conditions and trends, and where appropriate, utilize the data and information gathered through scorecards and reported metrics into new PIMs.

With respect to developing metric targets and scorecards, DER Intervenors emphasize the need to rely on primary data and data that can be readily and reliably verified. Some of this data may be currently available and in useable formats while some may not. DER Intervenors recommend the Commission incorporate either through a parallel proceeding or as part of Phase 2 a process for identifying data needs and protocols for data gathering and sharing to assist the Commission, HECO Companies, and parties in developing metric targets and scorecards, and PIMs.

3. *Other Regulatory Mechanisms*

a. Capex/Opex Equalization

The problems associated with capital versus operational expenditure bias were thoroughly vetted in Phase 1 of this proceeding. The Staff Proposal offers discussion of shared savings mechanisms, all-resource procurement mechanisms, rate-basing or earning a return on service-based solutions, capitalization of a prepaid contract, and totex accounting as approaches for reducing this bias. DER Intervenors look forward to exploring all of these mechanisms in Phase 2, but offer the following initial observations and recommendations in response to some of these approaches.

i. *All-resource procurement mechanisms*

The Staff Proposal states "[e]ffective all-resource procurements rely on competitive solicitations (i.e., open to non-utility solution providers) and—where appropriate—defining grid needs in terms of service requirements rather than predetermined technologies."[21] DER Intervenors agree that the utilities should take a technology neutral approach to sourcing grid solutions to ensure that all cost-effective alternatives are considered and adopted where appropriate. However, while competitive solicitations are one means by which to procure resources to meet power supply, grid infrastructure, and grid service needs, this mechanism comes with important shortcomings that can limit the ability of the utility to respond to near term (*e.g.*, one to three year planning horizon) grid needs and presents other challenges that reduce its effectiveness.[22] To overcome these shortcomings, other mechanisms should also be considered for sourcing grid solutions, including tariff-based procurement mechanisms.[23]

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21 *Id.* at 41.

22 *See*, Cal. Pub. Utils Comm'n, R.14-10-003, Rulemaking to Create a Consistent

Tariff-based mechanisms offer a cost-effective and administratively simple framework to encourage increased DER deployment, integrate customer-based solutions into distribution system planning for meeting grid needs on both the short- and long-term planning horizons, and create savings that can be shared between utilities and distribution ratepayers. The tariff framework also addresses shortcomings inherent in competitive solicitations to address NWA projects aimed at deferring or avoiding traditional infrastructure investments on a near-term planning horizon. It also offers the flexibility of applying tariff-based procurements to address other grid needs as they arise over a long-term planning horizon. PBR mechanisms should encourage innovative pilot programs that incorporate tariff-based procurement mechanisms and pay-for-performance frameworks to leverage DER assets and further the utility's ability to increase "DER asset effectiveness."

ii. *Return on service-based solutions*

DER Intervenors support the Staff Proposal's recommendation to explore a mechanism through which the utility can earn a rate of return on payments for service-based solutions, such as grid services from DERs, similar to returns on a capital investment.[24] As the Staff Proposal notes, there is support for this idea in other states. For instance, in California, the Competitive

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Regulatory Framework for the Guidance, Planning, and Evaluation of Integrated Distributed Energy Resources, *Amended Scoping Memo of Assigned Comm'r and Joint Ruling with Admin. Law Judge* at 4 (Feb. 12, 2018) (discussing certain shortcomings of the competitive solicitation process with respect to the deferment projects addressing shorter term and smaller magnitude needs and concluding that "projects such as voltage and reliability related projects with a forecasted in-service date of less than three years are not deferrable by distributed energy resources sourced through a solicitation project because of the time required to select deferral opportunities, launch a solicitation, evaluate bids, request Commission approval, and construct and interconnect a distributed energy resources project through to commercial operation").

[23] *See* Cal. Pub. Utils Comm'n, R.14-10-003, *Admin. Law Judge's Ruling Directing Proposals for Distributed Energy Resource Tariffs* (Nov. 16, 2018).

[24] Staff Proposal at 43.

Solicitation Framework Pilot allowed an incentive equal to 4% for annual DER payments that displace or defer capital expenditure on traditional distribution project investments. DER Intervenors further agree with the Staff Proposal's assessment that there are different perspectives how to "right size" DER incentives, but the incentive needs to be large enough to ensure non-capital intensive solutions receive fair consideration.[25] As California's extraordinarily slow pace of procurement of non-traditional distribution infrastructure indicates, utilities will be reluctant to earnestly pursue options with which they are not familiar and which would greatly diminish the return they would otherwise have the opportunity to earn with a traditional capital-intensive investment. This disincentive could be mitigated through differentiated ROE based on categorization of low- and high-risk utility capital investments to more directly link ROE with risk. Lower risk investments should receive a lower ROE, which could further reduce the utility bias against competitive market solutions to grid needs.

DER Intervenors also note that the return on service-based solutions mechanism can provide a transparent, predictable and long-term revenue earning opportunity as part of a platform service model.

iii. *Capitalization of a prepaid contract*

DER Intervenors also support the Staff Proposal's recommendation to explore allowing capitalization on prepaid contract by treating an expense (such as payments for a service) like a capital investment by placing it into the rate base, amortizing it, and recovering costs over time.[26] This is a worthy approach for both minimizing capex/opex bias and incentivizing utilities to integrate third-party service contracts into their resource portfolios. This will stimulate

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25 *Id.* at 44.

26 *Id.*

innovation in the types of services that utilities seek and that third party providers offers, foster competition to drive down utility service costs, and provide further support for the development of sustainable competitive energy service markets, including DER markets. The amortization term should attempt to match the useful life of the services received in order to avoid any stranded costs problems or technology "lock-in."

In sum, there are numerous approaches to eliminating the bias favoring utility capital investment to allow DER and other competitive market participants to provide non-wires solutions, grid services, transportation electrification, low-income energy services projects, and other DER implementation projects and programs. It is essential, however, that the Commission implement these mechanisms to ensure that *spending* bias (in any form) does not simply replace *capital* bias. Functional differentiation of utility activities, especially according to monopoly (*e.g.*, platform) versus competitive functions as discussed above, would be a prudent first step in addressing capital bias without creating new incentives for overspending.

b. Innovation

The long-term success of PBR in Hawaii is inherently dependent upon innovation, experimentation, and a willingness to try new approaches to meet the demand for energy services in response to customer needs, technological changes, market trends, environmental and public health considerations, and myriad other areas for which we simply cannot predict what the future will bring. Instituting a transparent and flexible PBR framework that encourages and rewards utility innovation over both the short- and long-term will further increase the chances of achieving long-term success of utility sector transformation.

DER Intervenors emphasize that in no area in this proceeding is innovation more important than the way that PBR can animate markets for DER and provide an increasingly

important role for non-utility competitive service providers to deliver ratepayer savings. In the near term, such innovation should include expedited processes for building on the commercial-scale rollout of the GSPA programs for DERs to address gaps in integrating DER solutions. These gaps should be closed through streamlined pilot programs, including a process for non-utility service providers to propose such programs. As a starting point, DER Intervenors recommend the Commission solicit ideas in Phase 2 for innovative pilot programs and other non-program based innovations for adoption as initial innovative pilots stemming from Phase 2.

For example, utility competitive solicitations for NWA opportunities are often (rightly or wrongly) still considered a significant "innovation" in how DER assets are leveraged to provide broader ratepayer benefits. NWA opportunities mark only a very small subset of the potential for integrated DER solutions to deliver transformational utility sector evolution in service of the goals and outcomes identified in the Staff Proposal. DERs have extensive capabilities that utilities and DER providers have only just begun to leverage. Incentivizing utility innovation can greatly accelerate the pace of unlocking the enormous DER service potential that exists in Hawaii.

Examples of utility innovation that could be developed include smart grid demonstration projects and tariff-based procurement mechanisms such as "bring-your-own-device" ("BYOD") styled programs. In contrast to the Green Mountain Power ("GMP") Tesla Powerwall pilot noted in the Staff Proposal, GMP and other utilities throughout New England and New York have adopted BYOD pilot programs through which customers are able to provide grid services through customer-owned or third-party-owned devices (as opposed to utility owned, as is the

case with the GMP Tesla Powerwall pilot).[27] Offering BYOD type programs through tariff-based mechanisms offers an administratively simple procurement alternative to competitive solicitations for avoiding utility infrastructure capital investment or providing grid services.

It is also essential that utilities are incentivized to seek innovative ideas from outside the utility walls by actively coordinating and partnering with third party service providers to incubate, develop, test, and implement innovative solutions to grid needs. Very often utilities do not have complete information to know whether or how third party service solutions could provide a lower cost solution to a traditional capital-intensive investment or grid service need. Similarly, third party providers very often do not have complete information to know whether or how to develop a perfectly tailored solution to a particular utility need. Regardless of whether the information is available for either party, market integration pathways to provide grid service solutions are currently extremely limited or non-existent to non-utility providers.

DER Intervenors recommend the PBR framework adopted in this proceeding put significant emphasis on encouraging greater innovation, particularly as it relates to animating DER markets. DER Intervenors further recommend that in addition to allowing utility cost-recovery for well-designed innovative pilots, the Commission adopt mechanisms to provide the utility incentives for developing innovative pilots that are rapidly scaled to system-wide deployment. This additional incentive could be through adjustments to shared saving

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[27] *See, e.g.*, New Hampshire Pub. Util. Comm'n, DE 17-189, Docket DE-17-189, *Liberty Utilities Petition to Approve Battery Storage Pilot Program, Order No 26,209* at 37 (Jan. 17, 2019) (approving "Bring-Your-Own-Device" program to provide peak load reduction); New York State Dept. of Pub. Serv., Matter No. 14-01299, In the Matter of PSE&G LI Utility 2.0 Long Range Plan, *Department of Public Service Recommendations Regarding PSE&G LI Annual 2018 Update* at 15-16 (Nov. 1, 2018) (supporting PSE&G LI proposal to implement a "Bring-Your-Own-Device" based-program open to third party aggregators to provide direct load control through energy storage and solar resources).

mechanisms through which the utility is allowed to retain a greater percentage of the savings that result from the pilot, a higher return on the service based contract for a set period of time, or a similar type of structure to provide a transparent price signal to incentivize continued utility innovation and collaboration with third-party providers.

c. Platform Service Revenues

DER Intervenors agree with the Staff Proposal's characterization of the platform model's ability to animate DER markets and deliver value across the spectrum of prioritized goals and outcomes. The Staff Proposal states:

> A platform business model may be particularly well-suited for electric utilities because, by harnessing a multi-sided DER market, platforms can leverage spare asset capacity at the grid edge, thereby providing network services and value to the power system overall, while also supporting innovative services that deliver customer-specific value. Moreover, as the administrator and operator of the platform, the utility could generate platform service revenues from actions that are aligned with customer preferences and state policy goals. The concept of a platform utility was discussed by numerous parties in the course of Phase 1 and is consistent with previous Commission guidance for the HECO companies to embrace functions associated with that of a network integrator and operator.[28]

The Staff Proposal correctly states that "[b]uilding a utility platform beyond infancy will require innovation and creativity" and that "opportunities for platform service revenues will likely derive from a rethinking of how current services are procured and produced, such as is being developed in the HECO Companies' DR Portfolio, or enabling new types of interactions between producers and consumers."[29]

The rethinking of how current services are procured and produced is a critical animating principle of this proceeding. Determining the appropriate mechanisms to institute at the initial stages of transition to PBR must facilitate this thinking and allow for efficient experimentation

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28 Staff Proposal at 50-51.

29 *Id.* at 51.

and implementation of changes to how services are procured and produced. This must at the same time mitigate ratepayer risk and maximize the likelihood of success to cost-effectively achieve prioritized goals and outcomes. The platform model offers both a procedural mechanism and an implementation pathway to facilitate this thinking, mitigate ratepayer risk and maximize the likelihood of success.

The platform model provides a framework for, among other things: (1) facilitating the identification of energy service functions best served by the regulated monopoly utility and those best served by competitive markets; (2) understanding, valuing, and animating the non-utility service market (e.g., the DER market) and the attendant utility revenue earning opportunities from the platform; (3) managing ratepayer and utility risk through phased implementation of different combinations and degrees of reliance on other regulatory mechanisms (*e.g.*, PIMs, cap-ex/op-ex equalization, innovation incentives, earning sharing mechanisms); and (4) combining the platform model with other regulatory mechanisms to align utility incentives with achieving specific goals and outcomes to maximize the likelihood of success.

One hallmark of success in the transition to PBR is empowering customers to participate in energy services markets. The platform model provides the framework for achieving this by providing customers a robust menu of choices to meet their own energy service needs as well as opportunities for customers to provide grid service needs through competitive service providers operating through, and with the support of, a market-neutral platform services provider. The platform model provides a high degree of transparency and flexibility for scaled implementation by targeting specific, lower-risk services in the early stages while dialing up the reliance on other mechanisms, such as PIMs, ESMs, mitigating capex/opex bias through return on service-based solutions and capitalization of a prepaid contract, and other measures as discussed above, and

providing additional incentives for successful utility innovation to create the foundation upon which to scale the platform model over the mid- to long-term. This will facilitate the creation of a new class of service revenues for the HECO Companies founded on supporting competitive DER markets and integrating competitive service providers into utility planning and grid operations.

A fully scaled platform model can be viewed as a market-based successor framework to more traditional regulatory mechanisms, such as decoupling. As described in the Staff Proposal, the platform model provides an open, participatory infrastructure for interactions between external producers and consumers, and sets governance conditions for them with the overarching purpose of facilitating transactions and creating value for all participants.[30] With the appropriate regulatory framework supporting it, a platform model can create a suite of revenue earning opportunities for the platform provider to perform traditional distribution service functions while at the same time incentivizing the utility to evolve its offerings, thereby further enhancing competitive market service integration to meet the broader set of prioritized goals and objectives.

IV. Conclusion

DER Intervenors again commend Staff and its consultants for their commitment to conducting a collaborative and constructive process throughout Phase I of this proceeding and setting the stage for transition to Phase 2. DER Intervenors recommend the Commission prioritize the following issues in Phase 2 of this proceeding:

(1) make findings distinguishing between monopoly and competitive market functions in providing electric service;

(2) formulate a strategic vision and plan for near- and long-term transition to a utility platform service model;

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30 *Id.* at 50.

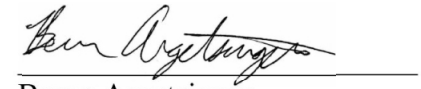
(3) develop a strategic plan for near- and long-term implementation of the PBR framework and utility earning incentive structures;

(4) immediately initiate a parallel proceeding focused on developing the data-rich environment necessary to stimulate and sustain DER integration and market innovation; and

(5) incorporate incentive mechanisms in the PBR framework that build on the commercial-scale roll-out of the GSPA programs to close any additional gaps to effectively integrating DER solutions to meet Hawaii's electric service needs.

DER Intervenors appreciate the opportunity to provide this statement of position in response to the thoughtful and well-crafted Staff Proposal in the spirit of aiding in the formulation of a Phase 1 decision and order and effective scope and focus for Phase 2 of this proceeding.

Respectfully submitted this 8th day of March, 2019.



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